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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Comment Requested on A La Carte and	)	
Themed Tier Programming and Pricing	)	MB Docket No. 04-207
Options for Programming Distribution On	)	
Cable Television and Direct Broadcast Satellite	)	
Systems	)	

REPLY COMMENTS OF THE WALT DISNEY COMPANY

These reply comments ("Reply Comments") are submitted on behalf of The Walt Disney Company ("TWDC"), ESPN, Inc. (80% owned by TWDC), Disney ABC Cable Networks Group (including Disney Channel, ABC Family, Toon Disney and SOAPnet), The ABC Television Network and the ABC-owned television stations (hereinafter collectively referred to as "Disney"). In these brief Reply Comments, Disney addresses two discrete points. First, contrary to the claims of several commenters, Disney does not tie carriage of its most popular programming services to carriage of other services. Second, a "voluntary" a la carte scheme is not a "middle ground" compromise because it would result in the same anti-consumer effects as mandatory a la carte and would unfairly interfere with private contractual negotiations by favoring and benefiting MVPDs. Each of these points is discussed in further detail below.

I. DISNEY DOES NOT TIE OR DEMAND UNREASONABLE TERMS FOR CARRIAGE OF ITS MOST POPULAR PROGRAMMING SERVICES

Contrary to several commenters' assertions, Disney does not tie or demand unreasonable terms for its most popular programming services. Specifically, Disney does not require MPVDs to carry any of its other programming services as a prerequisite to carrying Disney's most popular programming services (namely, the signals of the ABC-owned television stations, ESPN or Disney Channel).[1] Moreover, Disney does not require carriage of all its programming services on only the basic or expanded basic tier.[2]

A. Disney Offers All of Its Most Popular Programming Services on a Standalone Basis

First, contrary to the assertions of some commenters, Disney does not require carriage of its cable programming services in exchange for its consent to carriage of the ABC-owned television stations.[3] In fact, Disney offers carriage of its ABC-owned broadcast stations on a standalone basis for cash payments equal to far less than the actual value of such service.[4]

Several commenters have also incorrectly asserted that Disney ties carriage of its more popular programming services to carriage of other less widely-distributed programming services. For example, Pioneer Communications claims that a "popular sports network programmer"

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[1] *See, e.g.*, Comments of Pioneer Communications at 3; Comments of National Telecommunications Cooperative Association at 3; Comments of Center for Creative Voices in Media at 9.

[2] *See, e.g.*, Comments of American Cable Association at 3.

[3] *See* Declaration of Benjamin N. Pyne (attached hereto as Exhibit 1) ("Pyne Declaration"); *see also* Comments of The Walt Disney Company ("Disney Comments") at 44.

[4] *See* Disney Comments at 44; *see also* Michael G. Baumann and Kent W. Mikkelsen, THE FAIR MARKET VALUE OF LOCAL CABLE RETRANSMISSION RIGHTS FOR SELECTED ABC OWNED STATIONS, Disney Comments, Exhibit 2 (July 15, 2004) ("Retransmission Consent Study").

requires MVPDs to "carry no less than four other networks, all owned by the same sports media company, in order to be extended license to carry the one original marquee network."[5] To the extent this accusation is aimed at ESPN, it and other similar accusations of tying directed at Disney are false.[6]

In reality, ESPN offers the opportunity for any MVPD to carry only the ESPN service. ESPN does not require carriage of its complementary ESPN services like ESPN2 or ESPN Classic before it will negotiate for carriage of ESPN.[7] ESPN does provide the complementary ESPN-branded services only to those distributors who have licensed ESPN; however, no distributor who licenses ESPN is required to license any of the other ESPN-branded services.

Despite some commenters' assertions otherwise, Disney also does not require carriage of any of its other programming services before it will permit carriage of Disney Channel; an MVPD who wishes to carry Disney Channel without carrying other Disney programming services is free to do so.[8] As described in Disney's opening comments, when Toon Disney was first launched, it was made available as a complementary service only to those distributors who licensed Disney Channel. Since that time, Disney's policy has changed, and as a more mature service, Toon Disney is now offered to new licensees of the service on a standalone basis. Certain Toon Disney agreements that were executed under the original distribution policy remain

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[5] *See* Comments of Pioneer Communications at 3.

[6] Even if commenters' allegations were true—and they clearly are not—there still would be no basis to believe that such "facts" could serve as a basis for a claim of illegal tying. However, because Disney does not engage in the conduct alleged, there is no need to consider that question at this time.

[7] *See* Disney Comments at 35. Benjamin N. Pyne, Executive Vice President, Disney and ESPN Networks Affiliate Sales and Marketing, attests to these facts and others in his attached declaration. *See* Pyne Declaration.

[8] *See* Pyne Declaration; *see also* Disney Comments at 35.

in effect, but as they are renewed, the new policy is applied. As with ESPN, no distributor who licenses Disney Channel is or ever was required to license any of the other Disney ABC Cable Networks branded services.

B. Disney Permits Carriage of Its Programming Services on Various Tiers

Disney also offers MVPDs significant flexibility to choose the manner in which they carry its many programming services. For example, MVPDs may negotiate for carriage of ESPN2 and ESPN Classic on the first, second or third most widely-penetrated tier.[9] Disney negotiates for carriage of ESPN, Disney Channel and ABC Family on either the first or second most widely-penetrated tier of service.[10] Finally, ESPNEWS, Toon Disney and SOAPnet are available to be carried on any tier.[11]

C. Conclusion

The simple fact is that Disney offers all of its most popular programming services—ABC, ESPN and Disney Channel—on a standalone basis. If an MVPD wants to carry ABC alone, but not any other programming service (e.g., SOAPnet), Disney offers a cash deal for retransmission consent that will permit it to do so. If an MVPD wants to carry ESPN but not ESPN2, it can do so as well. The options Disney offers to MVPDs are too numerous and varied to list and commenters' accusations to the contrary are absolutely incorrect.

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[9] *See* Disney Comments at 35-36; Pyne Declaration.

[10] *See* Pyne Declaration.

[11] *See* Pyne Declaration.

II. "VOLUNTARY" A LA CARTE PROPOSALS ARE NOT A "MIDDLE GROUND"

Some commenters expressed support for "voluntary" a la carte schemes as a "middle ground" between mandatory a la carte and no a la carte regulation.[12] Under one type of "voluntary" a la carte, MVPDs would be required to offer programming services on an a la carte basis but, simultaneously, would be permitted to continue offering that same programming service as part of a tier, such as the expanded basic tier.[13] Other schemes labeled "voluntary" would make offering channels a la carte completely optional for the MVPD.[14] Both types of "voluntary" a la carte schemes would require programmers to sell their services in a manner that would permit an MVPD to offer the service a la carte. Both schemes also would trigger two troubling consequences: (i) they would harm consumers in all of the same ways as mandatory a la carte; and (ii) they would unfairly restrict the contracting rights of programmers.

A. "Voluntary" A La Carte and Mandatory A La Carte Both Would Result in Significant Anti-Consumer Harms

Commenters who support "voluntary" a la carte conveniently fail to mention the adverse consequences of such a scheme. In practice, "voluntary" a la carte would cause all of the same anti-consumer harms that mandatory a la carte would cause. Specifically, under a "voluntary" a la carte scheme:

- programming services would lose circulation, resulting in decreased advertising revenue and increased costs for consumers;[15]

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[12] *See* Comments of American Cable Association at 6-7; Comments of Broadband Service Providers Association at 3, 11-14; Comments of Center for Creative Voices in Media at 2; Comments of National Telecommunications Cooperative Association at 5-6.

[13] *See* Comments of American Cable Association at 6-7; Comments of Broadband Service Providers Association at 3, 11-14; Comments of National Telecommunications Cooperative Association at 5-6.

[14] *See* Comments of Center for Creative Voices in Media at 2.

[15] *See* Disney Comments at 12.

- competition for advertising would drop because fewer programming services could guarantee a truly national audience;[16]
- consumers would have to purchase expensive set top boxes; [17]
- programming diversity still would suffer;[18]
- MVPDs would have to spend more on transaction costs such as additional customer service personnel;[19]
- programmers would have to increase their marketing spending, the costs of which would be passed on to consumers;[20] and
- many program suppliers (e.g., major professional sports leagues) would likely not sell to services that are not fully distributed.[21]

The economic model and study submitted with Disney's comments provide empirical support for what should be obvious; the vast majority of households would suffer as much under a "voluntary" a la carte scheme as they would under a mandatory a la carte scenario.[22]

B. "Voluntary" A La Carte and Mandatory A La Carte Both Would Result in Significant Disruptions to the Advertising Market

As described in Disney's opening comments, a la carte would hurt competition for advertising and would decrease the ability of programming networks to sell advertising. Because any of the "voluntary" a la carte proposals would create uncertainty as to how many households

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[16] *See* Disney Comments at 13-16.

[17] *See* Disney Comments at 17.

[18] *See* Disney Comments at 28-29.

[19] *See* Disney Comments at 17-18.

[20] *See* Disney Comments at 18.

[21] "Issues Related to Competition and Subscriber Rates in the Cable Television Industry." U.S. General Accounting Office, GAO-04-8 (October 2003) ("GAO Report"), at pages 38-39.

[22] *See* Retransmission Consent Study.

would be subscribing to a programming network at any given time, these harms also would result from "voluntary" a la carte. Moreover, the method of measuring viewing by Nielsen – which is used as part of the buying and selling of advertising – would be substantially destabilized by any form of a la carte, whether "voluntary" or mandatory. Nielsen measures viewing in terms of total television households ("HHs") receiving a channel and a rating point represents a certain number of those HH's (1% of a cable channel's total subscribers). Under any form of a la carte, there would be constant and unpredictable shifts in the number of households represented by a rating point. Therefore, placing a value on those rating points would become highly unpredictable.

For example, under the current system, if a cable channel is part of expanded basic and is distributed within 50,000,000 television households, a rating point is worth 500,000 households (1% of 50 million). Because the line-up of expanded basic is fairly consistent from month to month (or any changes are predictable and known in advance), the number of households in which any given channel is available is fairly constant from month to month. Therefore, an advertiser who buys a 1.0 rating in June (500,000 HHs) can expect to deliver approximately the same number of households if it also purchases a 1.0 rating in August.

However, under an a la carte system, the number of households subscribing to any given cable channel would fluctuate from month to month. This would cause the value of the ratings points to fluctuate with the variations in each channel's coverage area. For example, if 80,000,000 households were to opt to purchase a channel one month, but only 40,000,000 were to purchase it the next month, the value of the rating point would have decreased from 800,000 HHS to 400,000 HHS. Such fluctuations raise the following questions, which illuminate problems any a la carte service would cause:

- Would an advertiser pay the same cost-per-rating point from month-to-month knowing it would get them only a portion of households and it would effectively increase the cost of reaching each household?
- How could an advertiser allocate a purchasing budget over several months if it would not know the number of households per rating point and therefore how the number of points it would need to reach a certain number of households would change?
- How would ratings' guarantees be affected? Programmers often guarantee a certain rating point delivery in selling advertising, but that point could be worth half as many households in October when the advertiser's spot would be aired as opposed to in September when the spot was originally purchased.

These questions represent only a portion of the number of disruptions to the advertising market that would be caused by any form of a la carte.

C. "Voluntary" A La Carte Would Involuntarily Restrict the Private Contract Rights of Programmers

In addition to the anti-consumer effects detailed above, so-called "voluntary" a la carte would unnecessarily limit the contracting rights of programmers. In this sense, "voluntary" a la carte is a complete misnomer because "voluntary" a la carte would not be voluntary for programmers. Rather, programmers would be involuntarily precluded from negotiating for their preferred type of carriage or business model. By imposing "voluntary" a la carte, the government would be interfering with an arms-length negotiation. At its core, "voluntary" a la carte is the government telling programmers: "You can sell your product as an a la carte service or you cannot sell it at all." This type of unprecedented government intervention in a private negotiation is indefensible, especially where, as here, there are no clear public policy benefits to such action because government intervention in this marketplace would result in the vast majority of consumers paying more, for less.

D. Conclusion

"Voluntary" a la carte is not voluntary for programmers. Such regulation effectively would force programmers to permit carriage of their channels in any manner the MVPD sees fit.

This unnecessary government meddling in private contract negotiation is especially egregious considering the anti-consumer effects of "voluntary" a la carte. Given these effects, "voluntary" a la carte is far from a "middle ground" compromise; it is contrary to the public interest and should not be mandated.

III. CONCLUSION

For the reasons stated herein and in its Comments, Disney urges the Commission and lawmakers to refrain from imposing any type of a la carte regulation.

Respectfully submitted,

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August 13, 2004

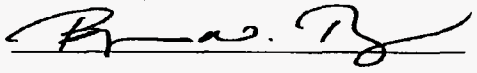
DECLARATION OF BENJAMIN N. PYNE

I, Benjamin N. Pyne, Executive Vice President, Disney and ESPN Networks Affiliate Sales and Marketing, have responsibility for negotiating for multi-channel video programming distributor ("MVPD") carriage of the ABC owned television stations and The Walt Disney Company's cable networks, including ESPN, ESPN2, ESPN Classic, ESPNEWS, Disney Channel, Toon Disney, ABC Family and SOAPnet.

I attest that, in negotiating for MVPD carriage:

- Disney does not require carriage of its cable programming services in exchange for its consent to carriage of its ABC-owned television stations;
- Disney offers carriage of its ABC-owned broadcast stations for standalone cash payments;
- Disney does not require carriage of any of its other programming services before it will permit carriage of Disney Channel;
- ESPN offers the opportunity for any MVPD to carry only the ESPN service;
- ESPN does not require carriage of any of its other programming services before it will permit carriage of the ESPN service;
- An MVPD who wishes to carry Disney Channel or ESPN without carrying other Disney programming services may elect to do so;
- Disney offers MVPDs significant flexibility to choose the manner in which they carry its many services;
- MVPDs may negotiate for carriage of ESPN2 and ESPN Classic on the first, second or third most widely-penetrated tier;
- Disney negotiates for carriage of ESPN, Disney Channel and ABC Family on either the first or second most widely-penetrated tier of service;
- ESPNEWS, Toon Disney and SOAPnet are available to be carried on any tier;
- Disney offers all of its most popular programming services—ABC, ESPN and Disney Channel—on a standalone basis;
- An MVPD may carry ESPN but not ESPN2; and
- An MVPD may carry ABC but not SOAPnet.

I hereby declare, under penalty of perjury, that, to the best of my knowledge, information and belief, all of the factual information contained herein is accurate and complete.



Benjamin N. Pyne
Executive Vice President, Disney and ESPN
Networks Affiliate Sales and Marketing

August 13, 2004

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
Inquiry Required by the Satellite Home Viewer Extension and Reauthorization Act on Rules Affecting Competition in the Television Marketplace	)	MB Docket No. 05-28

To: Secretary, Federal Communications Commission

REPLY COMMENTS

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EXECUTIVE SUMMARY

Congress enacted retransmission consent in 1992 in recognition of the fact that broadcasters have the right to require consent and compensation before another entity distributes their product. Nothing has changed in the marketplace since 1992 to justify any modifications to the statute or its implementing regulations.

Disney's reasonable retransmission consent practices comply with the statute and Commission decisions on retransmission consent. Disney negotiates retransmission consent only for the ten ABC Owned Stations. Disney does not require multichannel video programming distributors ("MVPDs") to carry any Disney-owned cable network to obtain retransmission consent but instead offers a reasonable stand-alone cash retransmission consent proposal as an alternative.

The retransmission consent practices challenged by MVPDs were conceived as an accommodation to cable operators who refused to pay cash for retransmission consent after the statute was enacted. Moreover, in enacting retransmission consent, Congress specifically anticipated agreements by cable operators to distribute new cable programming services as an alternative to cash payments and the Commission has affirmed the use of these types of transactions on several occasions.

Contrary to the assertions of the Joint Cable Commenters and Professor Rogerson, retransmission consent is not responsible for increased cable costs. Rather, non-programming costs, such as costs associated with offering new broadband services or the transition to digital television, drive cable rates. Additionally, as explained in a report attached as Exhibit B to these reply comments, when adjusted to account for improvements in service quality, cable rates are not increasing rapidly as Professor Rogerson claims.

To remedy perceived problems with retransmission consent, several commenters propose that the conditions imposed in the News Corp./Direct TV transaction be extended to all broadcasters. However, the rationale for imposing these conditions—the potential harm to competition in the vertical broadcast-distribution MVPD market—does not apply to retransmission consent generally because most broadcasters are not affiliated with an MVPD. Suggestions that all retransmission consent disputes be submitted to mandatory arbitration are equally unwarranted. In fact, commenters are unable to cite a single case where the Commission sanctioned a broadcaster for violating its obligation to negotiate in good faith.

Similarly, arguments that the broadcast exclusivity rules should be revised cannot be justified. Modifications to the broadcast exclusivity rules suggested by the MVPDs would upset the carefully legislated balance of negotiating power between broadcasters and MVPDs and would ultimately render a broadcaster's retransmission consent rights meaningless. Additionally, changes to the broadcast exclusivity rules would harm localism. The broadcast exclusivity rules promote the Commission's long-standing goal of localism by: (i) providing MVPD subscribers with access to local content produced by broadcasters and (ii) giving broadcasters the audience levels they need to justify producing expensive local content. Further, the broadcast exclusivity rules, which enable networks and broadcasters to negotiate programming exclusivity without interference from the government, are essential to the continued viability of the network-affiliate system.

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In the Matter of	)	
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REPLY COMMENTS

Pursuant to Section 1.415 of the rules of the Federal Communications Commission ("FCC" or "Commission"), The Walt Disney Company ("Disney")[1], through its attorneys, hereby submits reply comments ("Reply Comments") in the above-captioned proceeding in which the FCC seeks comment on the impact of the retransmission consent, network nonduplication, syndicated exclusivity, and sports blackout rules on competition in the multichannel video programming ("MVPD") market. As further set forth below, there is no need for the government to revise the current statutes or regulations governing retransmission consent,[2] network nonduplication,[3] or syndicated exclusivity.[4]

[1] The specific entities are: (i) ESPN, Inc. (80% owned by Disney) ("ESPN"), (ii) ABC Cable Networks Group (including The Disney Channel, ABC Family, Toon Disney and SoapNet), and (iii) the ABC Television Network ("ABC") and the ABC owned television stations ("ABC Owned Stations"). ABC and the ABC Owned Stations are ultimately owned by Disney.

[2] 47 U.S.C. § 325(b); 47 C.F.R. § 76.64-70.

[3] 47 C.F.R. § 76.120-122 and 76.92-95.

[4] 47 C.F.R. § 76.101-110, § 76.120, and § 76.123-125.

I. There is No Need to Revise the Current Statutes or Regulations Governing Retransmission Consent

A. Congress's Rationale For Enacting Retransmission Consent in 1992—that Broadcasters Have the Right to Require Consent Before Another Entity Distributes Their Product—Remains Equally Valid In Today's Marketplace

The Cable Television Consumer Protection Act of 1992 ("1992 Cable Act") requires cable systems to obtain the consent of, and to compensate the owner of, a broadcast channel before distributing that channel to consumers.[5] Prior to 1992, cable operators were able to obtain broadcast stations off air, distribute them to consumers, and keep the proceeds. In passing the 1992 Cable Act, Congress concluded that "a very substantial portion of the fees which consumers pay to cable systems is attributable to the value they receive from watching broadcast signals" and public policy should not support a system "under which broadcasters in effect subsidize the establishment of their chief competitors."[6] Congress further explained that "[c]able operators pay for the cable programming services they offer to their customers; the Committee believes that programming services which originate on a broadcast channel should not be treated differently."[7] In sum, Congress concluded that broadcasters, like all other programmers, have the right to require consent and compensation before another entity distributes their product.

Although the 1992 Cable Act merely equalized the competitive balance between broadcasters and cable operators, several commenters in this proceeding have made various allegations of broadcaster "abuses" of retransmission consent.[8] The essence of these allegations is the desire of a few distributors to return to a pre-1992 regime under which they enjoyed a

[5] Cable Television Consumer Protection and Competition Act of 1992, Pub. Law No. 102-385, 106 Stat. 1460 (1992).

[6] S. REP. NO. 102-92, at 35 (1991).

[7] *Id.*

[8] *See, e.g.,* Comments of Joint Cable Commenters, at 6-18; Comments of EchoStar Satellite L.L.C., at 3-8; Comments of the American Cable Association, at 7.

significant advantage over broadcasters, who had virtually no way to protect their content from being redistributed by MVPDs. Absent from these commenters' arguments is any valid explanation of what has changed since 1992 that would justify returning to the pre-1992 system.

One supposed justification proffered by commenters is the alleged inappropriate exchange of broadcast station retransmission consent for the carriage of cable channels under common ownership with the broadcaster. However, what these commenters fail to address sufficiently is that both Congress and the Commission consistently have approved of this practice. Notably, Congress specifically anticipated that the compensation paid by the cable operator to the broadcast station could take the form of "the right to program an additional channel on a cable system."[9] Recognizing the resulting public interest benefits, the Commission has affirmed the acceptability of such arrangements on several occasions. For example, in March 2000, the Commission ruled that—in the SHVIA context—proposals for carriage of a broadcast signal contingent on "carriage of any other programming, such as ... an affiliated cable programming service" are "consistent with competitive marketplace considerations."[10] In 2001, the Commission again stated that "offering retransmission consent in exchange for the carriage of other programming such as a cable channel" is "consistent with competitive marketplace considerations" and that "[g]ood faith negotiation requires only that the broadcaster at least consider some other form of consideration if the MVPD cannot accommodate such carriage."[11]

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[9] S. REP. NO. 102-92, at 36.

[10] *Implementation of the Satellite Home Viewer Improvement Act of 1999 – Retransmission Consent Issues: Good Faith Negotiation and Exclusivity*, 15 FCC Rcd 5445, 5469 (2000) ("*Good Faith Negotiation Order*").

[11] *EchoStar Satellite Corporation v. Young Broadcasting*, 16 FCC Rcd 15070, 15079 (Aug. 6, 2001).

Most recently, the Commission confirmed that antitrust laws, rather than FCC-imposed regulations, should govern any dispute over allegedly unlawful tying practices.[12]

Any departure from this established precedent would have to be supported by a well-founded reason for the change. However, nothing has happened since enactment of retransmission consent in 1992 to justify any changes to the statute or its implementing regulations. Instead, the fundamental notion behind retransmission consent remains as relevant today as it was in 1992: broadcasters—like any business—should be compensated for their product if distributed and sold by another entity. Broadcasters continue to invest billions of dollars annually to create the most valuable and most desired television programming in the industry and should have the right to be compensated for that product.

B. Disney's Retransmission Consent Practices Are Reasonable, Not Abusive

Several commenters assert that network broadcasters, including Disney/ABC, engage in allegedly "abusive" retransmission consent practices such as tying retransmission consent to carriage of cable networks or affiliate television stations.[13] As noted above, retransmission consent arrangements involving agreements to carry program services are in accordance with the 1992 Cable Act and Commission decisions. Moreover, as detailed below, Disney's retransmission consent practices are reasonable.[14]

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[12] *See Report on the Packaging and Sale of Video Programming Services to the Public*, at 80 (2004) ("*A La Carte Report*"). ("Nonetheless, the current retransmission consent process is a function of the statutory framework adopted by Congress and we cannot conclude that it is not working as intended. To the extent tying arrangements for carriage of particular programming is being used for anti-competitive ends, the antitrust laws provide an adequate remedy.").

[13] *See, e.g.*, Comments of Joint Cable Commenters, at 6-18; Comments of EchoStar Satellite L.L.C., at 3-8.

[14] These reasonable practices enabled Disney to conclude approximately 60 retransmission consent deals in the last cycle.

1. Disney Offers ABC on a Standalone Basis

As an initial matter, Disney negotiates retransmission consent only for its ten ABC Owned Stations (which have a 24% national reach) and does not negotiate on behalf of independently owned affiliate stations. Importantly, Disney does not require MVPDs to carry any ABC/Disney/ESPN cable network in order to obtain consent to retransmit any of its ten ABC Owned Stations. Instead, Disney offers MVPDs a stand-alone cash retransmission consent proposal for each of its ABC Owned Stations. This offer (in the range of $0.70 - 0.80 per subscriber per month) was made to each MVPD that was part of the last round of ABC's retransmission consent negotiations. If an MVPD agreed to a cash ABC retransmission deal, that MVPD was under no obligation to carry any other ABC/Disney/ESPN channel.[15]

In its initial comments in this proceeding ("Initial Comments"), Disney established that ABC's stand-alone retransmission consent price is completely reasonable and, in fact, understates the actual value of the ABC programming. As explained in the Initial Comments, Disney submitted an economic study, as part of the FCC's a la carte proceeding, that determined the fair market value of three of the ABC Owned Stations ("Retransmission Consent Economic

[15] To again confirm Disney's practices with respect to retransmission consent agreements for carrying the ABC Owned Stations, Disney is attaching the declaration executed by Ben Pyne, Executive Vice President, Disney and ESPN Networks Affiliate Sales and Marketing, on February 3, 2003. Mr. Pyne is the individual who is responsible for working with the ABC Owned Stations to negotiate retransmission agreements. In his declaration, Mr. Pyne certifies that, "in negotiating for retransmission consent, ABC offers MVPDs a cash stand-alone price for retransmission consent for the ABC Owned Stations. If the cable operator accepts that offer, that decision results in no additional obligation to carry any Disney/ABC programming. To the extent that any given MVPD decides not to accept ABC's stand-alone cash offer, and instead elects the alternative to negotiate to carry programming, that decision is made by the individual MVPD. We attempt to work with the MVPD to customize a reasonable offer to address their particular needs." *See* Declaration attached as Exhibit A.

Analysis").[16] The Retransmission Consent Economic Analysis concluded – based on three different approaches to assess the value of the ABC Owned Stations – that the average value of these stations ranged between $2.00 and $2.09 per subscriber per month, well in excess of the $0.70-0.80 per subscriber per month that ABC offers MVPDs.

2. Disney Offers Cable Operators Additional Flexibility

When negotiating with MVPDs—including the smaller rural carriers that may not be able to upgrade their plant in face of competition from advanced digital satellite services, Disney offers flexibility in striking a retransmission consent deal. For example, some small cable operators wish to retransmit an ABC Owned Station (but do not want to pay cash for the carriage), and yet they lack sufficient capacity on the same cable system to carry commonly-owned cable channels. In these instances, ABC has agreed to allow carriage of its station in market A in return for cable carriage of a commonly owned channel in market B where the cable operator does have sufficient channel capacity.[17] And, ABC will continue to work in good faith to accommodate the needs of smaller cable system operators. These practices are accommodations—not abuses—and in no way argue in favor of changes in retransmission consent.

Disney also permits MVPDs to obtain a license for its most popular individual cable channels without being obligated to obtain a license for any other Disney owned service. For example, an MVPD may elect to obtain a license for the Disney Channel but not Toon Disney, or

[16] *See* Michael G. Baumann and Kent W. Mikkelsen, THE FAIR MARKET VALUE OF LOCAL CABLE RETRANSMISSION RIGHTS FOR SELECTED ABC OWNED STATIONS (July 15, 2004).

[17] Ironically, this good faith accommodation by Disney has been twisted by a few operators into an allegation of bad faith. In fact, the flexibility to allow the retransmission consent compensation to occur in a different market is an accommodation to capacity constraints of the cable system owner.

may enter into standalone license agreements for SOAPnet or ABC Family. Further, a distribution license for ESPN does not obligate the cable or satellite operator to carry ESPN2, ESPN Classic or ESPNEWS.[18]

In addition to providing flexibility, Disney's contracting practices are in accordance with the Commission's intention to allow private negotiations to govern tier placement requirements. All tier placements of the Disney-owned cable channels are the result of private contractual negotiations between Disney and the MVPDs. As the Commission has acknowledged in its recent report on the packaging and sale of video programming services ("*A La Carte Report*"), "[t]ier placement requirements . . . are best left to commercial negotiations between MVPDs and program networks."[19] Antitrust law, rather than modifications to retransmission consent, provides a remedy for parties harmed by anti-competitive conduct.[20]

C. MVPDs Established the Retransmission Consent Practices That They Now Challenge as Abusive

As noted in Section I.A above, prior to 1992, cable operators distributed local broadcast signals without the consent of station owners. After the 1992 change in the law, many leading cable operators announced that they never would pay cash to a broadcaster for retransmission

[18] While ESPN offers the original "ESPN" channel on a standalone basis, it distributes the complementary ESPN-branded services (ESPN2, ESPNEWS and ESPN Classic) only to those distributors who have licensed the original basic "ESPN," and those distributors may then choose to license—or not to license—any one or more of the complementary ESPN-branded channels. Similarly, when Toon Disney was first launched, it was made available as a complementary service only to those distributors who licensed Disney Channel. Since that time, Disney's policy has changed, and as a more mature service, Toon Disney is now offered to new licensees of the service on a standalone basis. Certain Toon Disney agreements that were executed under the original distribution policy are still in effect, but as they are renewed, the new policy is applied.

[19] *A La Carte Report*, at 80.

[20] *Id.*

consent.[21] As the statutory deadline approached for completion of retransmission consent deals, a standoff ensued between the broadcasters and the cable operators.[22] This standoff threatened the continued cable carriage of many local broadcast stations.[23] This standoff was resolved when three of the then four major broadcast networks agreed to cable operators' proposals to grant retransmission consent for network-owned stations in return for cable carriage of, and payment for, new network-owned cable channels.[24] In return for granting broadcast retransmission consent, Fox created the cable network FX, ABC produced and distributed ESPN2 and NBC launched "America's Talking" (which later became MSNBC).[25]

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[21] *See* Mark Robichaux, *Tele-Communications Says It Will Fail to Meet Deadline on TV Stations' Fees*, THE WALL STREET JOURNAL, Aug. 18, 1993, at B8 ("Nearly all of the nation's largest cable operators have vowed to forgo paying cash to local TV stations."). The cable operators' prospective refusal to pay for retransmission rights was so uniform that Senator Daniel Inouye of Hawaii asked the Justice Department and the Federal Trade Commission to investigate whether the cable companies violated antitrust laws by improperly colluding with each other. *Id.*; *see also* Rachel W. Thompson, *Inouye to Cable: Why No Cash?*, MULTICHANNEL NEWS, Aug. 16, 1993.

[22] *See, e.g.*, Ted Sherman, *Consumers Loom as Losers in Battle Between Cable, Broadcast Firms*, THE NEWARK STAR-LEDGER, Sept. 13, 1993 (noting that after 1992 Cable Act established retransmission consent requirements, "[a]lmost every broadcaster initially demanded the cash [and] at the same time, nearly all cable operators said no, threatening to dump the on-air broadcast stations come Oct. 6, when the [retransmission consent] provision takes hold"); Robichaux, *supra* note 21 ("Delays in meeting the October deadline have been caused in part by the face-off between TV stations demanding new cash fees and cable systems steadfastly refusing to pay.").

[23] *See, e.g.*, Jeannine Aversa, Rachel W. Thompson & Rod Granger, *Storm Still Brews in Conn. as FCC Readies Final Must-Carry Rules*, MULTICHANNEL NEWS, Mar. 8, 1993 (noting Cablevision's threat to drop several broadcast stations, including those in Boston and Hartford/New Haven "if they don't forgo payment for carriage"). Some cable operators, including Cablevision, said they would offer subscribers switches to easily obtain broadcast programming over the air rather than pay broadcasters for their signals. *See* Sherman, *supra* note 22.

[24] *See* Sherman, note 22 ("Instead [of cash], the cable operators have been offering to swap spare channel capacity to the broadcasters for new cable programming that all networks are developing, in return for the right to retransmit regular, over-the-air programming.").

[25] *See* Sherman, *supra* note 22 (describing cable channels for which ABC, Fox, NBC and CBS negotiated carriage).

concludes that retransmission consent is responsible for the rapidly rising cost of basic cable service.[29] As explained in a report by Jeffrey A. Eisenach and Douglas A. Trueheart, attached as Exhibit B to these Reply Comments ("Eisenach/Trueheart Report"), Professor Rogerson's analysis is flawed.[30]

The Eisenach/Trueheart Report makes clear that programming costs alone do not drive increases in basic cable rates. Rather, programming costs are one factor among many that contribute to cable rate increases. As explained in the Eisenach/Trueheart Report, between 1996 and 2002, the cable industry spent over $75 billion on infrastructure and system upgrades. In 2004, cumulative capital expenditures by cable operators totaled over $80 billion. In comparison, programming costs in 2004 totaled $10.7 billion. The Eisenach/Trueheart Report further demonstrates that Professor Rogerson's conclusion that programming costs account for 42% of the rise in cable subscription rates is erroneous because Professor Rogerson's methodology is flawed. If Professor Rogerson's methodology is applied to determine the percentage of the increase in cable subscriber rates represented by costs other than programming, the increase in cable rates calculated using such methodology would be more than double the actual rise in cable rates.

Not only have non-programming costs played a more significant role in driving any purported increase in cable rates than programming costs, programming costs have remained relatively flat as a percentage of total costs.[31] To the extent programming costs have increased,

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[29] *See* Comments of Joint Cable Commenters, William P. Rogerson, Professor of Economics, Northwestern University, THE SOCIAL COST OF RETRANSMISSION CONSENT REGULATIONS (Feb. 28, 2005) ("ROGERSON REPORT").

[30] *See* Jeffrey A. Eisenach and Douglas A. Trueheart, RETRANSMISSION CONSENT AND CABLE TELEVISION PRICES (Mar. 31, 2005) ("EISENACH/TRUEHEART REPORT").

[31] *See id.*, at 16, Exhibit 9.

There are two critical points to make regarding these agreements which established the pattern of granting broadcast retransmission consent in return for carriage of commonly owned cable channels. First, these alternatives were conceived by cable operators[26] who—notwithstanding the 1992 Act—refused to pay cash for broadcast retransmission consent and were an accommodation to this refusal.[27] Second, as discussed above, these alternatives had been specifically anticipated and approved in the Senate Report to the 1992 Act.[28] Thus, it is MVPDs and not broadcasters who have established the terms of many current retransmission consent deals. For MVPDs now to complain about the very practice they insisted upon is outrageous.

D. Retransmission Consent Is Not Responsible for Increased Cable Costs

The Joint Cable Commenters ("JCC") submitted to the Commission a report by William P. Rogerson, Professor of Economics at Northwestern University, in which Professor Rogerson

[26] *See, e.g.*, Sherman, *supra* note 22 ("In a nearly united front...cable operators refused to negotiate with the networks, making it a possibility that cable subscribers would be forced to rely on conventional television reception to tune in to top rated shows..."); Rachel W. Thompson, *TCI Cuts 14 'Zero Pay' Carriage Agreements*, MULTICHANNEL NEWS, June 21, 1993 ("Cablevision Systems announced last Friday that it would offer broadcasters a single free cable channel in each of the markets where it operates that they can use" and "a package of free advertising time...in exchange for retransmission consent"); Jeannine Aversa, *Effros: Offer Broadcasters Leased Access*, MULTICHANNEL NEWS, May 3, 1993, at 18 ("At least one cable executive has an idea of how to deal with failed retransmission consent negotiations: Offer the broadcaster a leased access channel on the cable system's basic tier and let the station collect a fee directly from subscribers."); Mark Robichaux, CABLE COWBOY: JOHN MALONE AND THE RISE OF THE MODERN CABLE BUSINESS (John Wiley & Sons, Inc. 2002) ("TCI, for one, refused to pay cash to any of the big networks but it indicated it might be willing to make room on its systems for a new cable channel a broadcaster might like to start.")

[27] *See, e.g., Inouye Poses Antitrust Question on Retransmission Consent Decisions*, COMMUNICATIONS DAILY, Aug. 11, 1993 ("14 of top-20 cable MSOs said they wouldn't pay cash for retransmission consent"). MSOs that stated they would not pay for retransmission consent included TCI, Continental, Cablevision Industries, Coaxial, Colony, Comcast Crown, Harron, Jones, KBLCom, Newhouse, TeleCable, Time Warner and Viacom. *Id.*

[28] *See supra* at pp. 3-4.

cable operators have been able to offset a portion of these costs through the sale of local advertising, a fact that the JCC ignores. As illustrated in the Eisenach/Trueheart Report, in the past five years, cable operators have seen an 87% increase in the amount of advertising revenue generated per subscriber. Ultimately, however, the cable interests want the best of both worlds, *i.e.* they want to pay less for programming that increases their advertising revenues. Such a result would be unwarranted, unreasonable, and unrealistic.

The Eisenach/Trueheart Report further demonstrates that when adjusted to account for improvements in service quality, cable rates are not, in fact, rising rapidly as Professor Rogerson contends. Professor Rogerson relies on data in the Commission's most recent annual report on competition in the MVPD market to reach his conclusion that programming costs are responsible for rising cable rates. Examining this data alone, however, is an insufficient means of analyzing the effect of retransmission consent on cable prices because it fails to account for costs associated with increases in the quality of service. The Eisenach/Trueheart Report analyzes cable costs per channel and shows that, over the last five years, the price of basic cable service on a per channel basis has risen at a rate of only 0.4%, much slower than the rate of inflation. The Eisenach/Trueheart Report also considers cable costs per hour viewed and finds that the adjusted price of basic cable per viewing hour decreased by almost 7% between 1999 and 2003. Thus, it is clear that, when improvements to the quality of cable service provided to customers are taken into account, cable prices are not increasing rapidly as Professor Rogerson claims.

E. Proposed Modifications to the Current Retransmission Consent Procedures Are Irrelevant and Unnecessary

In their comments, the cable interests propose several specific modifications to the current retransmission consent procedures. Among these are recommendations that Congress: (i) extend the conditions imposed in the News Corporation Limited ("News Corp.")/DirecTV

Holdings LLC ("DirecTV") transaction; and (ii) modify existing retransmission consent procedures to require that all retransmission consent disputes be submitted to mandatory arbitration.[32] As further set forth below, these proposed modifications are unnecessary and should not be adopted.

1. *The Commission Should Not Extend the Conditions Imposed in the News Corp./DirecTV Transaction Because the Rationale For Imposing Such Conditions Does Not Apply to Retransmission Consent Generally*

In approving the proposed merger between News Corp. and DirecTV, the Commission concluded that the transaction could create an incentive for the combined entity to withhold retransmission consent from other MVPDs.[33] To alleviate the potential for competitive harm, the Commission conditioned its approval on compliance with two primary conditions.[34] Several commenters argue that the Commission should recommend to Congress that it impose these conditions on all broadcasters.[35] There is no basis for such action because the principal reasons for imposing the News Corp./DirectTV conditions do not apply to broadcasters, as further set forth below.

[32] *See, e.g.,* Comments of EchoStar Satellite L.L.C, at 8-11, Comments of American Cable Association, at 11, Comments of BellSouth Corporation and BellSouth Entertainment, L.L.C., at 8.

[33] *See General Motors Corporation and Hughes Electronic Corporation, Transferors, and The News Corporation Limited, Transferee, For Authority to Transfer Control*, MB Docket No. 03-124 (rel. Jan. 14, 2004) ("*News Corp./DirecTV Order*").

[34] Specifically, the Commission (1) required News Corp. to provide cable programming networks with non-discriminatory access to News Corp.'s owned and affiliated broadcast stations and (2) permitted MVPDs to submit retransmission consent disputes to arbitration. *Id.* at ¶¶ 218-226.

[35] *See, e.g.,* Comments of EchoStar Satellite L.L.C., at 8-11, Comments of American Cable Association, at 3 & 11.

First, the Commission's conclusions regarding the merger of News Corp. and DirecTV are not relevant to retransmission consent policies generally because, in reaching these conclusions, the Commission was concerned with the effect of the transaction on competition in the vertical broadcast-MVPD distribution market. Specifically, the Commission considered the potential for harm to non-affiliated MVPDs arising from the combination of a broadcaster, News Corp., and an MVPD, DirecTV, and found that, due to the vertical integration of these two types of entities, News Corp would have an increased ability to temporarily foreclose on provision of programming during retransmission consent negotiations given that it could direct defecting subscribers to DirecTV.[36] Such concerns generally are not present in retransmission consent negotiations involving broadcasters since most broadcasters (including Disney) are not affiliated with an MVPD.

Further, antitrust authorities subsequently decided not to employ these conditions in situations not involving vertical integration concerns, a fact ignored by commenters. Specifically, in the Federal Trade Commission's ("FTC") approval of the merger of NBC and Vivendi Universal Entertainment,[37] the FTC implicitly rejected arguments that the merger of a broadcast network and a content supplier may provide the combined entity with increased bargaining power in retransmission consent negotiations.[38] Since the transaction did not pose vertical integration concerns, competition would not be harmed because MVPDs would have multiple sources from which to secure programming. Accordingly, the Commission should

[36] *News Corp./DirecTV Order*, at ¶ 206.

[37] *See* Letter from Susan A. Creighton, Director, Federal Trade Commission, to Jean-Francois Dubos, General Counsel, Vivendi Universal S.A. (Apr. 20, 2004) (determining that further review of the proposed merger was unnecessary).

[38] *See* Jayne O'Donnell, *NBC, Vivendi Merger Hits Possible Snag*, USA TODAY, (Dec. 31, 2003), *available at* http://www.usatoday.com/money/media/2003-12-31-merger_x.htm.

follow this on-point precedent and reject the proposal to impose conditions on broadcasters absent a specific demonstration of such vertical integration concerns.

Second, the assertions by some commenters that the Commission determined in the *News Corp./DirecTV Order* that all broadcasters possess substantial market power to coerce acceptance of unfair retransmission consent agreements by MVPDs[39] is incorrect. Nowhere in the *News Corp./DirecTV Order* did the Commission find that broadcasters exercise market power at a level that is sufficient to harm competition. Although the Commission concluded that News Corp. possessed some market power in certain DMAs, the Commission did not reach any conclusions regarding the broadcast industry.[40] In fact, subsequently the Commission clarified that it was not passing upon the competitive balance of negotiating power that normally exists between broadcasters/programmers and MVPDs in the *News Corp./DirecTV Order.*[41]

Lastly, statements that broadcast-owned cable channels or networks are dominant forces in the market for MVPD programming are also incorrect.[42] As described in the Eisenach/Trueheart Report, broadcast-owned cable networks are far from dominant and

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[39] *See, e.g.,* ROGERSON REPORT, at 26 ("[T]he Commission's more general conclusion that broadcasters have market power with respect to their broadcast signals most certainly is relevant [to consideration of retransmission consent]."); Comments of EchoStar Satellite, L.L.C., at 5 ("To the extent there was any doubt about the market power of each major broadcasting network, the Commission has now definitively settled that question in the *News Corp.* decision"),.

[40] Nor did the Commission find that News Corp., absent the merger, enjoyed an unfair advantage over MVPDs in retransmission consent negotiations.

[41] *A La Carte Report*, at 70. Professor Rogerson ignores this statement in his attempt to refute arguments that the FCC's conclusions in the *News Corp./DirecTV Order* do not apply to retransmission consent broadly. *See* ROGERSON REPORT, at 26-27. In fact, in recent retransmission consent disputes, it has been said that "[c]able systems in bigger markets have more leverage because broadcasters have more money at stake." John M. Higgins and Bill McConnell, *No Cash, No Carry*, BROADCASTING & CABLE, Feb. 7, 2005, *available at* http://www.broadcastingcable.com.

[42] *See, e.g.,* Comments of Joint Cable Operators, at 6-28.

represent a small percentage of all cable networks, the overall number of which continues to increase.[43] Additionally, the Commission has acknowledged the diverse ownership of the most popular cable networks, thus indicating that broadcast-owned cable networks do not control programming in the MVPD market. In fact, the Eisenach/Trueheart Report points out that even Professor Rogerson's calculations regarding market share are more consistent with the FCC's findings of diversity than with dominance.[44]

2. *Other Suggested Modifications of Retransmission Consent Procedures Cannot Be Justified*

Several commenters also urge the Commission to recommend to Congress certain procedural changes, such as binding arbitration, to the existing retransmission consent regime.[45] These changes are not justified because there is no evidence indicating that the existing regime, which requires broadcasters to negotiate retransmission consent agreements in good faith and provides specific rules governing the retransmission consent complaint process, is ineffective.

The requirement that broadcasters negotiate in good faith was enacted by Congress in 1999 as a means to facilitate retransmission consent negotiations while still enabling the market to drive these negotiations.[46] In 2000, the Commission promulgated regulations to implement this provision, including regulations governing the process for filing retransmission consent complaints.[47] At that time, the Commission decided not to require arbitration because "[t]here

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[43] *See* EISENACH/TRUEHEART REPORT, at 12.

[44] *Id.* at 13.

[45] *See, e.g.,* Comments of EchoStar Satellite L.L.C, at 8-11, Comments of American Cable Association, at 11, Comments of BellSouth Corporation and BellSouth Entertainment, L.L.C., at 8.

[46] *See Good Faith Negotiation Order*, at 5448.

[47] *See id.*

has not been a sufficient demonstration that such a measure is necessary to implement the good faith provision of Section 325(b)(3)(C)."[48] Since then, no showing has been made to the Commission to establish the inadequacy or violations of the good faith negotiation rules that would warrant implementing binding arbitration.[49] Indeed, commenters are unable to cite a single case where the Commission actually sanctioned a broadcaster for violating its obligation to negotiate in good faith. In fact, the Commission has had only one opportunity to consider the issue and, in that case, determined that the broadcaster fulfilled its statutory obligation.[50]

Further, in enacting the Satellite Home Viewer Extension and Reauthorization Act, Congress extended the sunset date of the good faith negotiation requirement by five years and expanded the obligation to apply to all participants—MVPDs and broadcasters—in retransmission consent negotiations.[51] If Congress was concerned that the good faith negotiation provisions of the Act were ineffective, it would have implemented an alternative remedy, such as mandatory arbitration. For this and other reasons set forth above, there is no basis for modifying the existing retransmission consent regime.

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[48] *Id.*

[49] Contrary to statements by several commenters, the *News Corp./DirecTV Order* does not provide a basis for implementing mandatory arbitration because, as discussed above, broadcasters generally are not affiliated with MVPDs.

[50] *See EchoStar Satellite Corp.*, 16 FCC Rcd at 15079. In this case, EchoStar brought a complaint against Young for allegedly violating the good faith negotiation requirement. The Commission applied a two-part test to determine whether such violation occurred. First, the Commission determined that Young did not violate the good faith negotiation requirement under an objective standard because Young did not refuse to (1) negotiate with EchoStar; (2) meet and negotiate in a reasonable time and manner, or (3) advance more than one unilateral proposal. Second, the Commission concluded that, considering the totality of the circumstances surrounding the dispute, Young negotiated in good faith. Thus, the Commission dismissed EchoStar's complaint.

[51] 47 U.S.C. § 325(C).

II. There Is No Need For the Government to Revise the Current Statutes or Regulations Governing Exclusivity

The network non-duplication and syndicated exclusivity rules (together, the "Exclusivity Rules") were promulgated decades ago to protect programming for which broadcasters had negotiated exclusive rights and, in turn, to protect advertising revenues generated by such programming. The purpose of the Exclusivity Rules is "to allow all participants in the marketplace to determine, based on their own best business judgment, what degree of programming exclusivity will best allow them to compete in the marketplace and most effectively serve their viewers."[52]

The Commission already has concluded that the absence of such rules directly harms the ability of broadcasters to compete against cable operators.[53] This conclusion remains true today because, as audience levels of broadcast stations continue to decline in the face of competition from MVPDs,[54] the Exclusivity Rules ensure that local broadcast audiences (and, thus, advertising revenues) do not further decline as a result of duplicate programming that is retransmitted in a local market in contravention of contractual arrangements between television stations, their networks and other program suppliers. Further, there is no evidence that the

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[52] *Amendment of Parts 73 and 76 of the Commission's Rules Relating to the Program Exclusivity in the Cable and Broadcasting Industries*, 3 FCC Rcd 5299, 5319 (1988) ("*Exclusivity Rules Order*").

[53] Specifically, in 1988, the Commission found that, in light of the growing number of cable operators, "the potential for duplicating broadcasters' programs, diverting broadcasters' audiences and advertising *as a result of an unbalanced regulatory regime* [(e.g. a regulatory scheme without exclusivity protection)] is far greater than we expected it to be when we rescinded our syndicated exclusivity rules." *See id.*, at 5305 (emphasis added).

[54] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, Eleventh Annual Report, MB Docket No. 04-227, FCC 05-13, ¶ ¶ 14, 77 (rel. Feb. 4, 2005) ("[B]roadcast television stations' audience shares have continued to fall as cable and DBS penetration, the number of cable channels, and the number of nonbroadcast networks continue to grow.").

Exclusivity Rules are ineffective. Indeed, the Exclusivity Rules, by enabling broadcasters to negotiate and enforce program exclusivity, contribute to the "operation of a fully competitive market" for program distribution.[55]

A. There Is No Reason To Alter the Negotiated Exclusivity Between Networks and Their Affiliates

In its 1988 order regarding the Exclusivity Rules, the Commission explicitly endorsed the network-affiliate system as an efficient means of program distribution and determined that "enforcement of reasonable exclusivity" was necessary to support distribution of network programming.[56] The Exclusivity Rules prevent MVPDs from retransmitting duplicate out-of-market network programming in a market where a network and its local affiliate have negotiated exclusivity. Such rules protect network advertising revenues, which the Commission has determined are "an essential underpinning of the network-affiliate relationship."[57] Thus, the Commission should not make any changes to its Exclusivity Rules because any changes that would allow MVPDs to import an out-of-market broadcaster's identical network programming into the local market without regards to negotiated exclusivity rights would jeopardize the continued vitality of the network system.

B. The Exclusivity Rules Enhance Localism

Commenters' proposed elimination of or modifications to the Exclusivity Rules also would harm localism and run contrary to Section 307(b) of the Act which requires the Commission to ensure that individual community interests are served.[58] The current Exclusivity

[55] *Exclusivity Rules Order*, at 5302.

[56] *Id.*, at 5318.

[57] *Id.*

[58] 47 U.S.C. § 307(b).

Rules promote the Commission's long-standing goal of localism by: (i) providing MVPD subscribers with access to local content produced by broadcasters; and (ii) giving broadcasters the audience levels they need in order to justify producing expensive local content. Specifically, without the Exclusivity Rules, MVPDs would be able to retransmit distant out-of-market programming into the local market without any consideration as to such station's programming actually serves the interests of the community into which it is retransmitted. At the same time, viewers would be diverted from the local broadcast station, thereby reducing the local broadcaster's advertising revenues. With less advertising revenue, a local broadcaster's ability to produce high quality locally oriented news and information services would be seriously impaired. Ultimately, elimination or modification of the Exclusivity Rules would jeopardize the viability of local television stations and their ability to serve their local community.

C. Suggested Revisions to the Exclusivity Rules Are A Back-Door Attempt To Repeal Retransmission Consent

As discussed above, the Exclusivity Rules effectively promote the Commission's goal of localism and support the network-affiliate system. Nonetheless, several commenters assert that the Exclusivity Rules should be eliminated under certain circumstances because they place MVPDs at a distinct disadvantage during retransmission consent negotiations.[59] Specifically, the National Cable and Telecommunications Association ("NCTA") and the American Cable Association ("ACA") request that the Exclusivity Rules be modified to prohibit broadcasters who elect retransmission consent from exercising their rights under the Exclusivity Rules.[60]

[59] *See, e.g.,* Comments of Joint Cable Commenters, at 14, Comments of the National Cable & Telecommunications Association, at 12.

[60] *See*, Comments of the National Cable & Telecommunications Association, at 12; American Cable Association, Petition for Rulemaking to Amend 47 C.F.R. § § 76.64, 76.93, and

Although these proposals are characterized as "modifications" to the existing rules, they seek to eliminate the Exclusivity Rules in their entirety for broadcasters electing retransmission consent, a result not proposed or contemplated by the Commission's public notice in this proceeding or otherwise warranted.[61]

Complaints about the Exclusivity Rules are a back-door attempt to repeal retransmission consent. The Exclusivity Rules do not unfairly enhance a broadcaster's position in retransmission consent negotiations. Rather, the Exclusivity Rules merely respect a network's contractual decision to distribute programming in a certain way. Further, the Exclusivity Rules, which were established prior to the enactment of retransmission consent, were taken into consideration in adopting the existing retransmission consent scheme, [62] which seeks to balance the relative negotiating positions of broadcasters and MVPDs.[63] The modifications suggested

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76.103: Retransmission Consent, Network Non-Duplication, and Syndicated Exclusivity (filed Mar. 2, 2005).

[61] In the public notice governing this proceeding, the Commission sought comment only on the impact of the Exclusivity Rules on competition in the MVPD market. The FCC did not seek comment on repeal of these rules. *See Media Bureau Seeks Comment For Inquiry Required by the Satellite Home Viewer Extension and Reauthorization Act on Rules Affecting Competition in the Television Marketplace*, Public Notice, MB Docket No. 05-28, DA 05-169 (rel. Jan. 25, 2005).

[62] Congress recognized the importance of the interplay between retransmission consent and the Exclusivity Rules in 1992 and concluded that modifications to the Exclusivity Rules "in a manner which would allow distant stations to be submitted on cable systems for carriage or local stations carrying the same programming would . . . be inconsistent with the regulatory structure created in [the Act]." S. REP. NO. 102-92, at 38.

[63] *See News Corp./DirecTV Order*, at ¶ 180 ("Both programmer and MVPD benefit when carriage is arranged: the station benefits from carriage because its programming and advertising will likely reach more households when carried by MVPDs than otherwise, and the MVPDs benefit because the station's programming adds to the attraction of the MVPD subscription to consumers. Thus, the local television broadcaster and the MVPD negotiate in the context of a roughly even 'balance of terror' in which the failure to resolve local broadcast carriage disputes through the retransmission consent process potentially damages each side greatly in their core business endeavor.")

by the cable interests, however, would upset this balance of power. If the Exclusivity Rules are modified as requested, broadcasters will have far less bargaining power in retransmission consent negotiations because, as the cable interests correctly state, an MVPD simply could contract to carry the signal of a non-local station instead of the local station. In sum, elimination of, or modifications to, the Exclusivity Rules would negate broadcasters' bargaining power while at the same time strengthening that of MVPDs and, ultimately, would render a broadcaster's retransmission consent rights meaningless.

III. CONCLUSION

As demonstrated in these Reply Comments and the attached exhibits, there is no need for the government to revise the current statutes or regulations regarding retransmission consent, network nonduplication, or syndicated exclusivity.

Respectfully Submitted,

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March 31, 2005

EXHIBIT A

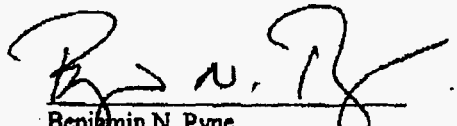
EXHIBIT A

DECLARATION OF BEN PYNE

I am Senior Vice President of Affiliate Sales and Marketing for ABC Cable Networks Group. Among other responsibilities, I am responsible for working with the ABC owned television stations to negotiate retransmission agreements for the ten ABC owned television stations.

I attest that, in negotiating for retransmission consent, ABC offers MVPDs a cash stand-alone price for retransmission consent for the ABC owned stations. If the cable operator accepts that offer, that decision results in no additional obligation to carry any Disney/ABC programming. To the extent that any given MVPD decides not to accept ABC's stand-alone cash offer, and instead elects the alternative to negotiate to carry programming, that decision is made by the individual MVPD. We attempt to work with the MVPD to customize a reasonable offer to address their particular needs.

I hereby declare, under penalty of perjury, that, to the best of my knowledge, information, and belief, all of the factual information contained in this Declaration is accurate and complete.



Benjamin N. Pyne
Senior Vice President of Affiliate
Sales and Marketing
ABC Cable Networks Group

February 3, 2003

CAP ANALYSIS

RETRANSMISSION CONSENT AND CABLE TELEVISION PRICES

March 31, 2005

Jeffrey A. Eisenach
Executive Vice Chairman

Douglas A. Trueheart
Senior Vice President

Note: Support for this study was provided by The Walt Disney Company. The views expressed are those of the authors. CapAnalysis is an economic and financial consulting firm located in Washington, DC. For more information, visit www.capanalysis.com.

Contents

List Of Exhibits

I. INTRODUCTION

We have been asked by The Walt Disney Company to evaluate a report by William P. Rogerson that was submitted to the Federal Communications Commission (FCC or Commission) by the Joint Cable Commenters (JCC) as part of the Commission's *Inquiry on Rules Affecting Competition in the Television Marketplace*.[1] Professor Rogerson and JCC argue that retransmission consent "has been a major contributing factor to the size and price of the expanded basic tier."[2] Specifically, Professor Rogerson concludes that,

> [S]ince the passage of retransmission consent, the Big Four broadcasters have grown to dominate the MVPD network programming industry. Subscription prices for cable TV have risen significantly over the past decade, and there is wide agreement that increases in programming costs have been an important factor fueling these price rises. .... [T]he passage of retransmission consent regulations likely played a major role in contributing to these increases in programming costs by allowing broadcasters to exercise their market power over their broadcast signals.[3]

We examine these issues and conclude that: (a) cable prices are not rising rapidly, especially when adjusted to reflect changes in quality; (b) programming costs account for a very small proportion of recent cost increases experienced by cable operators, the bulk of which are associated with their investments in new digital infrastructure and services such as broadband and telephony; (c) retransmission consent does not harm competition or consumers, but instead contributes to consumer welfare in the markets for broadcast/MVPD programming and distribution.

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[1] William P. Rogerson, "The Social Cost of Retransmission Consent Regulations," (February 28, 2005) (submitted as Attachment A to Comments of Joint Cable Commenters, MB Docket No. 05-28, March 1, 2005). Hereafter, "Social Cost" and "JCC Comments," respectively.

[2] JCC Comments at 5.

[3] Social Cost at 19.

In Section II of this report, we examine the relationship between programming costs and cable rates. Section III focuses on the competitive effects of retransmission consent. Section IV presents a brief summary.

II. PROGRAMMING COSTS ARE NOT DRIVING INCREASES IN CABLE RATES

Professor Rogerson argues that "cable subscription prices have been rising at a very fast rate since passage of the Telecommunications Act in 1996,"[4] and that "there is wide agreement that increases in programming costs have been an important factor fueling these price rises."[5] Retransmission consent is responsible, he says, because it allows broadcasters to "negotiate some combination of higher license fees and increased carriage than they otherwise would have been able to negotiate."[6]

We examined the determinants of cable rates in some detail in a 2003 study.[7] We concluded then that,

> ...cable rates, properly understood, are not rising faster than the rate of inflation – indeed, in real terms they are falling. Moreover, programming costs represent only a small fraction of the overall cost increases experienced by cable TV operators in recent years, and clearly are not the primary driver of retail rates.[8]

In this section, we review the most recent data, and conclude that cable rates, properly understood, are still not rising faster than inflation, and programming costs are still not the primary driver of cable cost structures.

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[4] Social Cost at 17.
[5] Social Cost at 19.
[6] Social Cost at 37.
[7] Jeffrey A. Eisenach and Douglas A. Trueheart, *Rising Cable TV Rates: Are Programming Costs the Villain,* CapAnalysis, LLC (October 23, 2003). Hereafter "2003 Report."
[8] 2003 Report at 1.

A. Quality Adjusted Cable Rates Are Not Rising Rapidly

Each year, the Commission surveys a random sample of cable operators and publishes a report on changes in cable industry prices.[9] The survey provides a basis for estimating prices paid by subscribers for basic and expanded basic (hereafter collectively referred to as "basic") programming services.

At the time of our 2003 report, the data showed that monthly basic subscription rates had risen by 8.2% during in the preceding period (July 2001-July 2002), much faster than the consumer price index, which rose by 1.5%. We argued then, however, that monthly subscription prices fail to take into account changes in quality, such as the number of channels of programming. We showed then that when such factors were taken into account, cable television prices were level or actually falling in real terms. The same results hold today.

The Commission's most recent survey indicates that basic rates increased by 5.4% between January 1, 2003 and January 1, 2004, a period during which consumer prices as a whole, as measured by the rise in the consumer price index, rose 1.1%. Furthermore, over the five-year period ending January 1, 2004 basic cable rates rose at an annual rate of 7.5% compared with 2.1% for the consumer price index. In other words, just as in 2003, the survey seems on its face to suggest that basic cable rates are rising faster than inflation.

As we noted in 2003, however, this data "fails to take into account improvements in product quality, most notably a substantial increase in the number of channels offered

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[9] See Federal Communications Commission, *Report on Cable TV Prices*, MM Docket No. 92-266 (February 4, 2005) (hereafter "Cable Price Report"). (The most recent report moved the reporting period from July-July to January-January.)

as part of basic cable programming packages."[10] Cable subscribers place a high value on programming variety and diversity, as evidenced, for example, by the fact that these product attributes have played a key role in the highly successful efforts of DBS providers to win customers away from cable operators.[11] Thus, it is appropriate to adjust cable subscription prices to reflect changes in the number of channels carried, i.e., to measure cable prices by the cost per channel.

The FCC agrees this is an appropriate basis by which to measure cable rates, and in fact does so in its report. Between January 1, 2003 and January 1, 2004, the Commission reports, the average number of channels carried on the basic tier increased from 67.5 to 70.3. As reflected in Exhibit One below, adjusting the increase in subscription rates to reflect this growth in channels shows that the rate per channel rose by only 1.1% during 2003, and only 0.4% annually over the past five years. Thus, on a per channel basis, over the past five years rates have risen more slowly than inflation.

Exhibit One:
Changes in Cable TV Rates, 1999-2004

	Increase in Average Monthly Rates	Increase in Average Monthly Rate Per Channel	Consumer Price Index
Jan. 2003 to Jan. 2004	5.4%	1.1%	1.1%
5-year average (Jan. 1999 to Jan. 2004)	7.5%	0.4%	2.1%

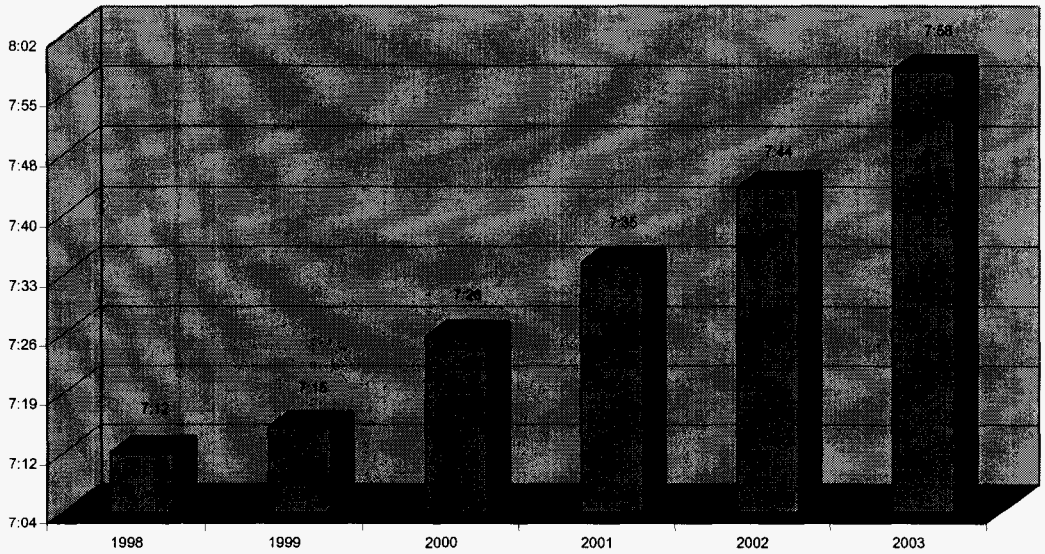
Source: Cable Price Report at 9.

[10] 2003 Report at 4.

[11] See, e.g., the first item on the list of competitive advantages listed by DirecTV on its web page: "The DIRECTV® TOTAL CHOICE® package gives you over 125 digital channels for $41.99/mo, including your local channels. For the same price with cable, you'll typically get 60-90 analog channels." (www.directv.com/DTVAPP/get_directv/directv_vs_cable.dsp, viewed March 28, 2005).

Professor Rogerson suggests that the additional channels being carried on cable networks are of little or no value to consumers.[12] Yet there are numerous indicators that consumers value the increasing quality and diversity of cable TV programming. For example, as shown in Exhibit Two below, the actual viewing time of cable TV households increased by 46 minutes, or more than 10%, between 1998 and 2003. And, as shown in Exhibit Three, cable's share of that time increased as well, from only 50% in 1998 to 60% in 2003.

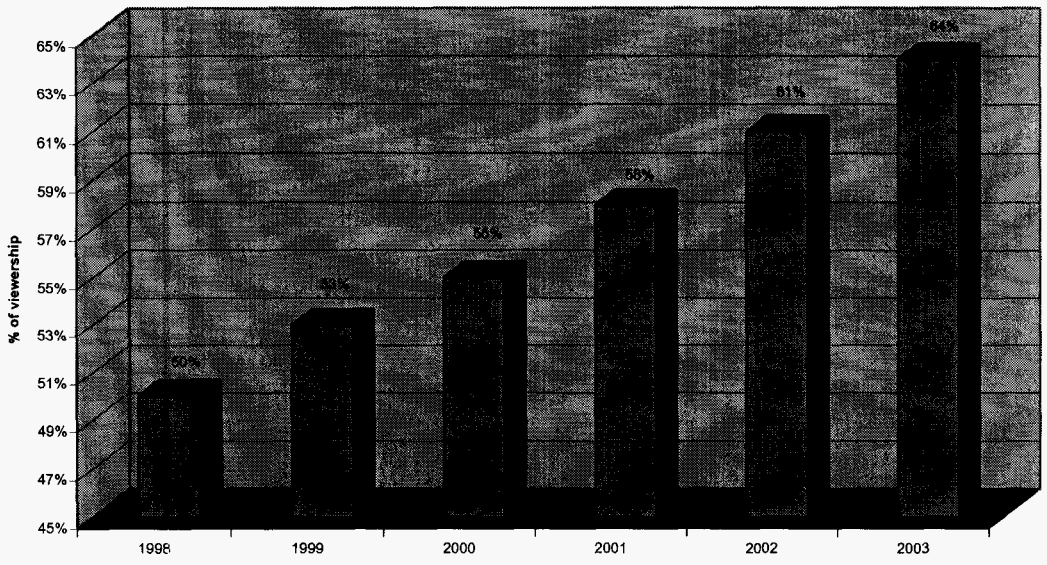
EXHIBIT TWO:
TV Viewing per Household (in hours)



Sources: Kagan Media Trends 2002 (pg. 251); 2002 and 2003 calculated based on growth data from "Veronis Suhler Stevenson Communications Industry Forecast & Report," 2004.

[12] See Social Cost at 4 (arguing that cable operators are forced to "purchase additional programming that they might otherwise not have purchased" and "Consumers also are harmed because these tie-ins...distort the selection of programs that is available to MVPD subscribers.")

EXHIBIT THREE:
Cable Share in Cable TV Households

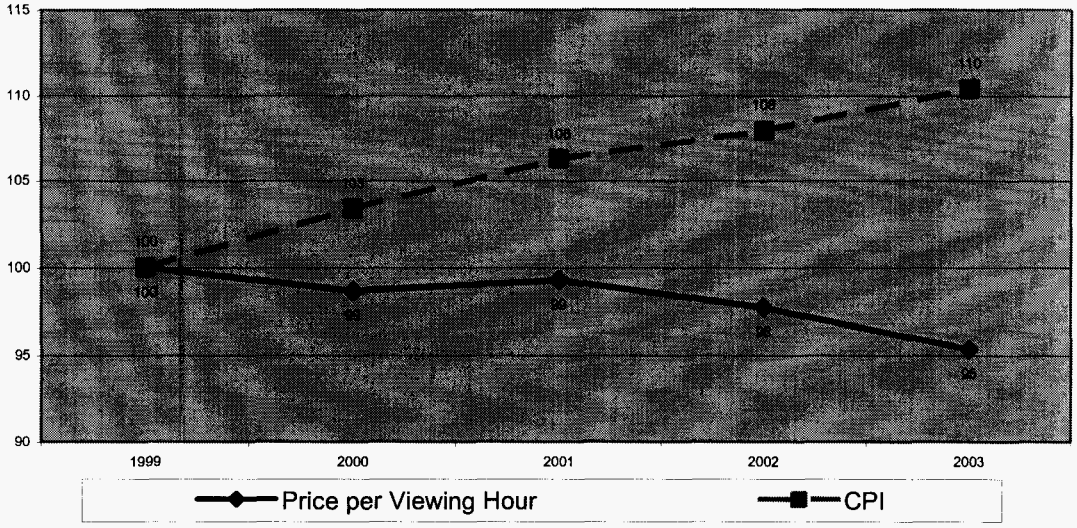


SOURCE: Kagan Economics of Basic Cable Networks 2005 (pg. 46)

Using this above data, we can calculate what is perhaps the most valid measure of the value received by cable subscribers: cost per hour viewed. As reflected in Exhibit Four, the nominal price per hour viewed for cable subscribers decreased at an average annual rate of 1% from 1999 through 2003, while the consumer price index increased at an average annual rate of 2.1% over the same period. Thus, the inflation adjusted price per viewing hour actually decreased by 6.8% during the period.[13]

[13] The conclusion that inflation adjusted price per viewing hour is actually decreasing is also supported by a study by Professor Steven Wildman sponsored by the NCTA. Professor Wildman concluded that the inflation adjusted price per viewing hour decreased by more than 15 percent over the ten-year period from 1993 through 2003. See Steven Wildman, "Assessing Quality-Adjusted Changes in the Real Price of Basic Cable Service" (September 10, 2003; attachment to NCTA Comments in MB Docket 03-172.)

EXHIBIT FOUR:
Cable Television Price per Viewing Hour vs. CPI, 1999-2003
(Index: 1999 = 100)



The increase in TV viewing cited above also suggests that subscribers feel that the quality of the programming being provided has also increased, as evidenced by the fact that the number of prime time Emmys received by cable companies increased by 254% from 1992 through 2003.[14] This increasing quality is not free. As indicated in Exhibit Five below, programming expenditures by the national cable program networks increased at an average annual rate of 14% from 1999 through 2005, much faster average annual increase in cable rates charged to basic subscribers found by the FCC for the same period. [15]

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[14] Social Cost at 58.

[15] The increase in programming costs also reflects increased capital expenditures and operating costs associated with producing digital and high definition content. While these costs are difficult to quantify, in part due to the fact that they have been incurred in large part by independent, privately-held production companies, they are certainly significant.

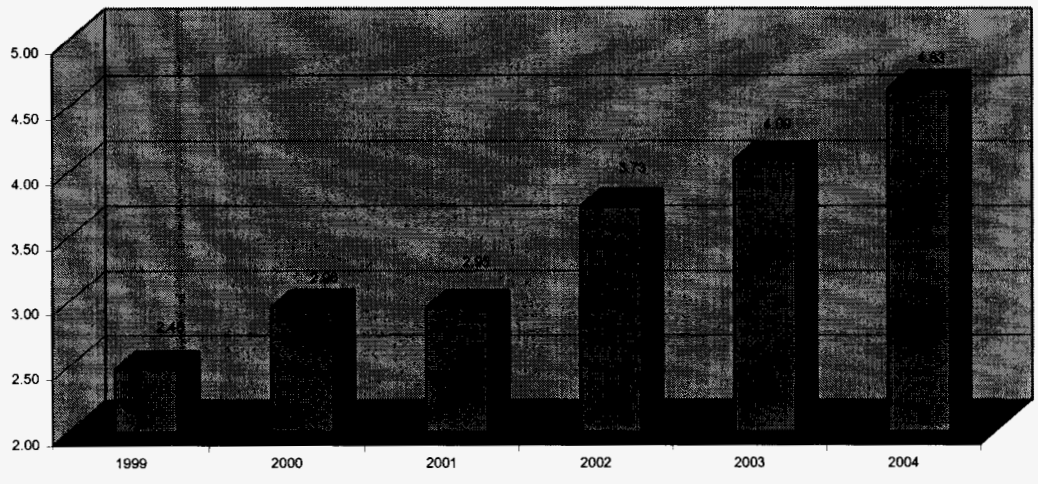
EXHIBIT FIVE:
Programming Expenditures of MVPD Networks

Year	Millions of $	Annual % Change
1999	$6,445	18.0%
2000	$7,265	12.7%
2001	$8,024	10.4%
2002	$9,072	13.1%
2003	$10,413	14.8%
2004	$11,559	11.0%
2005[est.]	$12,862	11.3%

Source: Kagan, "Broadband Cable Financial Databook," 2004.

It should also be noted that that the increase in the quality of programming and the corresponding increase in viewership have resulted in a direct benefit to the cable operators: an increase in advertising revenues. As indicated in Exhibit Six below, on a per subscriber basis net advertising revenue to the cable operators increased by 13% from 2003 to 2004 and by 87% from 1999 through 2004. At least a portion of this increase should be used to offset the costs of programming.

EXHIBIT SIX:
Monthly Cable Operator Advertising Revenues per Subscriber
1999-2004



Source: 2004 Kagan

B. Programming Costs Are Not Driving Cable Cost Increases

Professor Rogerson argues it is "well recognized" that "cable operators' costs of purchasing programming have also been rising at a very rapid rate and that a substantial share of the price increases that consumers have experienced simply reflects a pass-through of these cost increases."[16] In support of this proposition, he cites a March 2004 report by the General Accounting Office,[17] and a 2003 rebuttal, by Rogerson himself, of our October 2003 report.[18] His interpretation of the GAO report is misleading, and his 2003 report is simply incorrect.

Rogerson quotes one paragraph from the 21-page GAO report, which concludes that programming costs are "one important factor contributing to higher cable rates."[19] But GAO also found that "a variety of factors contribute to cable rate increases,"[20] that "the cable industry has spent over $75 billion between 1996 and 2002 to upgrade its infrastructure," and that "investments in system upgrades contributed to increases in consumer cable rates."[21] Perhaps most importantly, the GAO report found that "competition among networks to produce and show content that will attract viewers has become more intense," "bid up the cost of key inputs," "sparked more investment in

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[16] Social Cost at 18.

[17] "Subscriber Rates and Competition in the Cable Television Industry," *Statement of Mark L. Goldstein, Director, Physical Infrastructure Issues, U.S. General Accounting Office, Before the Committee on Commerce, Science and Transportation, U.S. Senate*, (March 25, 2004). (Hereafter "GAO 2004.") (The GAO's name has since been changed to the "Government Accountability Office.")

[18] William P. Rogerson, Correcting the Errors in the ESPN/CapAnalysis Study on Programming Cost Increases (November 11, 2003). (Hereafter, Rogerson 2003.) Rogerson's rebuttal was commissioned by Cox Communications at a time when Cox seeking to justify *a la carte* regulation of cable programming on the grounds that cable rates were rising and that programming costs (specifically, ESPN's license fees) were to blame. See below for a discussion of Cox's "revised and extended" views on this issue.

[19] GAO 2004 at 3.

[20] GAO 2004 at 9.

[21] GAO 2004 at 11.

programming," and "improve[ed] the quality of programming generally."[22] All of these findings are consistent with our analysis above, and explain why any meaningful analysis of cable rates and programming costs must take into account changes in the quality and quantity of programming being offered to cable subscribers.

Rogerson's second citation for the proposition that programming costs are responsible for rising cable rates is his own report. Based on our 2003 empirical analysis of MVPD cost structures, he calculated that net programming costs (after a partial correction to reflect the value of increasing advertising revenues) had risen by $2.96 per subscriber between 1999 and 2002, and then compared that figure with the increase in basic cable rates of $7.06 over that period of time. His conclusion, which he repeats in his new report, is that "42% [$2.96/$7.06] of the actual rise in subscription prices for cable TV can be explained by the rise in programming costs in the sense that this is the amount prices would have had to rise in order for cable systems to recover their increased programming costs."[23]

This conclusion is nonsense, as can been seen by applying Rogerson's methodology to the rest of the cost picture (which we presented as part of the same analysis from which Rogerson drew his $2.96 figure).[24] When we look at other costs, we see that "Capital Expense" rose by $5.05 between 1999 and 2002, while "Other Operating Expense" rose by $7.33. If we applied Rogerson's methodology to these figures (i.e., divide each by the $7.06 increase in monthly cable rates) we would conclude that Capital Expenses "explain" 72% ($5.05/$7.06) of the "actual rise in

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[22] GAO 2004 at 10.
[23] Rogerson 2003 at 7.
[24] See 2003 Report at 12, Figure 5.

subscription prices," while Other Operating Expenses "explain" 104% ($7.33/$7.06). The three factors taken together, in other words, "explain" 218% (42% + 72% + 104%) of the rise in cable prices.

Our 2003 conclusion – that programming costs accounted for only about 22% of the increase in cable costs between 1999 and 2002 – was based on a detailed examination of cable system expenses over that period of time. We found then that the increases in capital spending and non-programming operating costs associated with the cable operators' decision to upgrade their networks to provide digital television, Internet access, telephony and other services, were a "far more significant source of cost increases than programming."[25] We also noted that the advanced broadband, telephony and HDTV services made possible by the cable operators' investments "have not yet been fully realized; and thus despite the fact that they are not yet benefiting from the increased costs of the new technologies, basic cable subscribers are bearing the costs of these upgrades."[26]

Now, nearly three years later, the transition from analog to digital is largely complete. As shown in Exhibit Seven below, cumulative capital expenditures now total over $80 billion (about $1,250 per subscriber), but as of 2004, 97% of cable subscribers were served by systems offering digital programming, 95% by systems offering cable internet access and 29% by systems offering telephony.[27]

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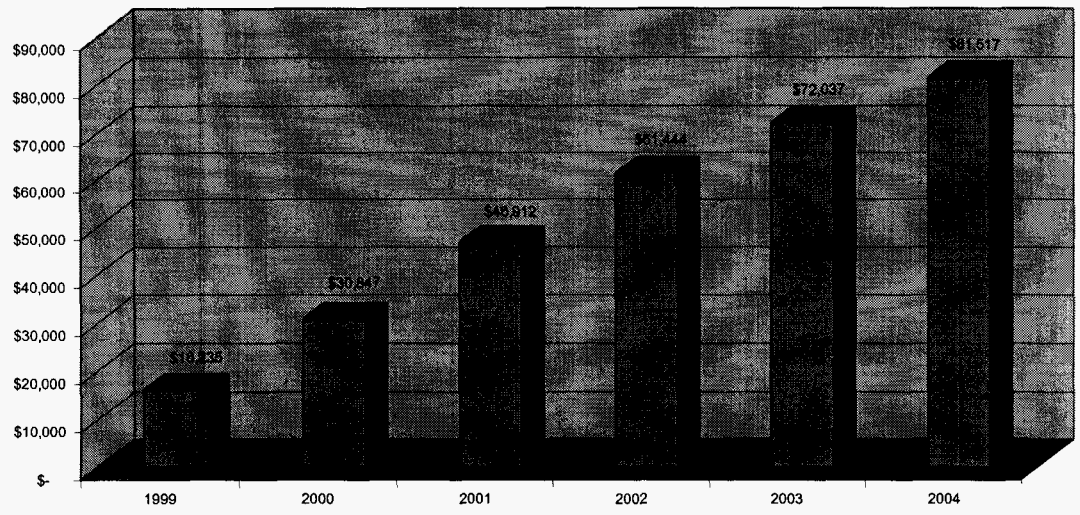
[25] 2003 Report at 17. Our findings were largely in accord with those of a May 2003 NCTA White Paper. See National Cable & Telecommunications Association, "Cable Pricing, Value and Costs," NCTA White Paper (May 2003).

[26] 2003 Report at 17.

[27] Cable Price Report at ¶37, Table 10.

EXHIBIT SEVEN:
Cumulative Investment in Plant by Cable Operators
1999-2004 ($ million)



SOURCE: Kagan World Media, " Broadband Cable Financial Databook 2004

Not surprisingly, as illustrated in Exhibit Eight below, revenue from advanced services has grown at a far more rapid rate than revenue from basic service, growing by 51% from $19.1 billion in 2002 to $28.9 billion in 2004, compared with growth in basic service revenue of only 9.6% over the same period. Non-basic revenue represented just over 40% of total revenue in 2002, but had grown to nearly 49% in 2004.